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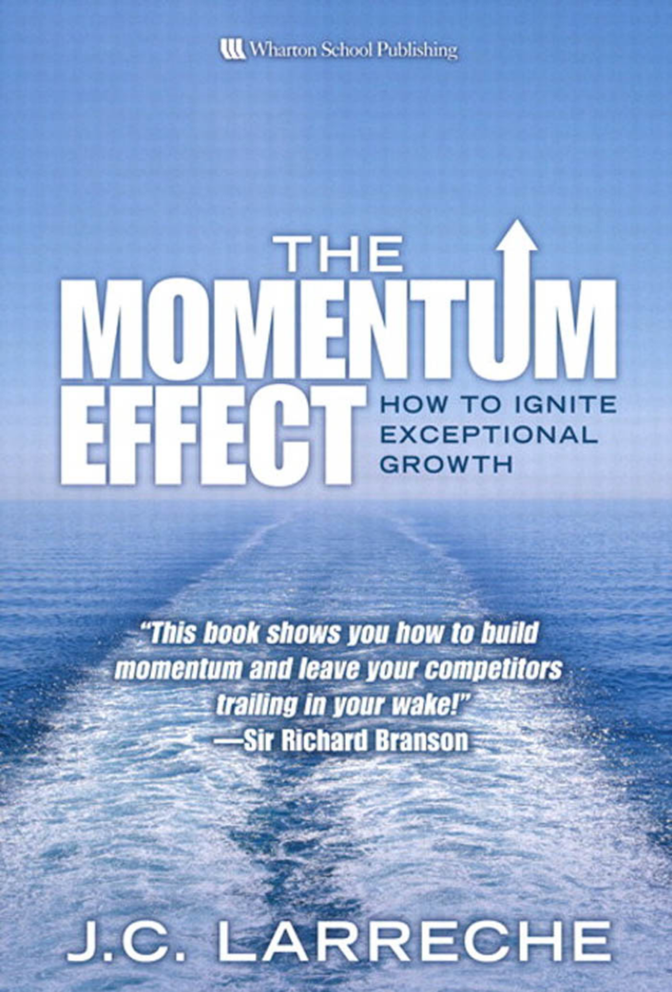

THE MOMENTUM EFFECT

HOW TO IGNITE EXCEPTIONAL GROWTH

"This book shows you how to build momentum and leave your competitors trailing in your wake!"
—Sir Richard Branson

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Preface

Delivering profitable growth year after year is the number-one, non-negotiable imperative facing today's business leaders. Many firms struggle to meet it, others achieve it in fits and starts, but only a select few consistently exceed it—sometimes extravagantly. How do these world-beaters do it?

The answer lies in the *momentum effect.*[1]

The momentum effect is a tremendously potent phenomenon by which, under specific conditions, exceptional organic growth is created—growth that feeds on itself. Momentum accumulates energy from its own success and provides ever-increasing acceleration for firms smart enough to build and harness it. These firms go from success to success, buoyed by a self-sustaining growth which sweeps all before them with disconcerting ease.

Momentum allows you to deliver exceptional growth without the stupendous efforts most firms are forced to make every day. It is this self-fueling characteristic of the growth produced by the momentum effect that leads us to call it *momentum growth* and to use the word *exceptional.* Momentum growth is exceptional for two reasons. First, because it is characterized by an exceptional *rate* of growth—exceptional, that is, compared to normal expectations based on history, market trends, or competition. Second, it offers an exceptional *quality* of growth, one that both generates higher profits and consumes fewer resources.

This book reveals evidence for the momentum effect, demonstrates how it works, and then offers you a pathway to harnessing its power.

The first inkling that a force such as momentum might explain some firms' exceptional growth occurred during my business studies at Stanford University. There, in the heart of Silicon Valley, I became fascinated by the way some businesses suddenly took off, experiencing almost unimaginable growth, whereas others, with what appeared to be technologically superior offerings, sank without a trace. Since then, I have sought out the engines of growth that help companies to create superior value, aided in this endeavor by different teams over time. We began by investigating marketing excellence. We examined customer focus. We scrutinized innovation. Each of these is a useful tool with an undeniable impact on growth, but painful experience over the years has taught us that marketing excellence by itself does not create sustained growth any more than does customer focus or innovation in isolation. We discovered that momentum growth requires a delicate combination of a number of specific elements, working cooperatively and simultaneously. This combination can occur by chance or by design. But even with the best-laid plans, it can work its full magic only if it is executed within a special culture and under a certain type of leadership.[2]

The momentum that builds as a result is what drove the extraordinary performance of Microsoft, Wal-Mart, and Dell, momentum that then deserted them, and momentum they are struggling to recover. The same near-irresistible energy is powering Apple, Toyota, Virgin, First Direct, and Nintendo today. But if those companies fail to maintain it intelligently, they too could wake to find the momentum behind their growth deserting them. That's the tricky thing about momentum: It is transitory. Without constant care, its power will prove fleeting.

Momentum is dynamic. In business, success can vanish in a flash unless it is constantly renewed. Several of the firms we studied lost their momentum because their leaders failed to understand or nurture the drivers of this force. Many of the stories we tell are of firms that are no longer excellent. And, almost certainly, some of the companies whose praises we sing will lose their momentum all too soon. But all these firms have built momentum and ridden it for all it was worth, some of them for decades. The ability not only to build momentum but, more importantly, to retain your grip on it is one of this book's key takeaways.

After sketching out the first rough outlines of the momentum effect, we embarked on a systematic investigation to expand and refine our comprehension of how it worked. We confirmed its existence as a long-term phenomenon through an empirical study of the world's largest firms, examining their growth in revenues, profits, and shareholder value over 20 years. We conducted in-depth studies of a vast number of small and large firms that enjoyed periods of exceptional growth over the past 50 years. We have generally considered that if a company has sustained this growth for at least ten years, the forces behind that growth were worth investigating—even if that growth has subsequently slumped. We often learned as much from the slump as we did from studying the initial growth. We have made exceptions to this ten-year rule only for recent ventures such as Skype, Nintendo's Wii, and Facebook. We used computerized simulations to replicate the phenomenon and to test different drivers of momentum. We advised client companies on specific aspects of momentum strategy, and tested their implementation.

What we learned was so wide-ranging that it would not sit comfortably within a single book, and we must leave many of our findings to subsequent publications. In these pages, we focus on a single purpose: to present a systematic approach for the design and execution of momentum strategy. This involves an eight-step process creating the specific conditions required to set the momentum effect in motion and to maintain it. This process integrates in a single framework a number of contributions that have emerged in the past decade, in academia and in business, mainly in the areas of customer focus, innovation, and marketing excellence.

Taken individually, each element of momentum strategy is very simple. It is part creativity, part business acumen, part psychology, and part simple common sense. You have to have smarts, not a Ph.D. Many entrepreneurs who created momentum for their firms and held it over several decades never completed university studies, either because of necessity or because they were impatient to go into business—Thomas Edison, Henry Ford, Steve Jobs, Luciano Benetton, Richard Branson, Michael Dell, and Bill Gates, to name a few.

But if the concepts are simple, successfully implementing a momentum strategy is challenging. "In strategy," wrote Clausewitz, "Everything is very simple, but not on that account very easy." This is keenly pertinent to momentum strategy, where the challenge is to first build and then maintain the balance that creates momentum and sustains it over time. For this, we offer a framework that assembles the pieces of the momentum-strategy puzzle into a coherent whole.

This book is divided into four parts. The first, *Discovering Momentum,* provides the evidence for the momentum effect and explains the phenomenon. It then presents the concepts of momentum strategy and demonstrates its role in value creation before describing a framework for momentum. Each of the eight steps of this momentum process is then examined over the two central parts of the book: *Designing Momentum* and *Executing Momentum.* The final part, *Total Momentum,* closes the loop. It concentrates on the creation of internal momentum and on the leadership competences required to successfully implement momentum strategy and create exceptional growth.

Like sports, the business environment of today's globalized, hypercompetitive world will increasingly become divided into leagues. The top league will consist of momentum-powered businesses enjoying exceptional growth. All the others will be trying to play catch-up. Given the choice, wouldn't you prefer to spend your future in the excitement and accomplishments of the Momentum League? Our most sincere wish is that this book helps you to create and experience to the fullest the stimulation and rewards of momentum.

1

The Power of Momentum

Where's the Impetus?

Momentum. Most businesses get it at some point: the impression that everything they undertake succeeds effortlessly, as if they're being carried along by a tailwind that increases their efficiency and propels them on to exceptional growth.[1]

Some hold on to it. Most don't. Slowly, imperceptibly, the tailwind turns around and the momentum disappears, without anyone quite realizing what has happened. The company is still growing, but not as strongly as before, not as efficiently. Everyone's maxing out, but it seems like there's molasses in the works. Sound familiar?

Sooner or later, it hits you in the face. Imagine you are meeting up with a senior analyst whose opinion counts with some of your company's biggest investors. You think you're on safe ground—after all, your company is doing better than the competition. But the analyst is in full gimlet-eyed, illusion-killing mode. "That's nothing to crow about," she says. "Yeah, you've got reasonable growth, but it's nothing exceptional. You're a safe bet, nothing more. Okay, I might tell my mom to buy, but then she's happy with inflation plus one. The way we see it, you're really grinding it out. We reckon the strain's getting harder, too. There's no impetus—no momentum."

Words like that can really take the gloss off a day. The next time you gather your team, you don't congratulate them on beating their targets—you want more. Sure, our results are up, you say, but that's not enough—where's the impetus? When are we going to do something exceptional? With all the resources at your disposal, when are you going to start building some momentum?

The team members look at their papers. Then Paul, an anxious member of your team, looks up and says: "Okay. Got any ideas about how?" What are you going to say?

What's Holding Us Back?

This book sets out to answer one question: How can I find a way to deliver continuous, exceptional growth, year after year?

By *exceptional,* we mean exceptional relative to expectations: growth that sets you apart. In some high-technology markets, this might mean 60 percent. In others, 6 percent might really stand out from the crowd if the market average is just 3 or 4. What we are talking about is growth that puts serious distance between you and your competitors. That is what this book is offering. It shows you how to get the traction you need to make sure that none of your effort is being wasted—to make sure that it all goes toward delivering tangible results. It will help you break free from the grind.

After all, grind is what most businesses endure. Most firms that manage to deliver growth do it the hard way. Measures that improve profitability often hold back top-line growth, while measures that drive revenue growth require investments that can drag down profitability. As one foot starts to run, the other starts sinking in the mire. It's devilishly hard to get the balance right and break free: It seems that all you can do is keep pushing. Companies have to push sales forward with big marketing investments while at the same time harrying their employees to become more productive and nagging their suppliers and partners for better deals. Pushing is hard work—it's exhausting and it churns through resources.

We thought: "There just *has* to be a better way than this." Some of our earlier work[2] showed that firms with certain shared characteristics were delivering substantially better results than others. The performance of these firms suggested that, under certain conditions, there existed a phenomenon whereby growth could be achieved more efficiently. The disproportionately higher growth these firms delivered hinted at some hidden energy driving their growth—an energy that seemed to feed on itself without the need for excessive resources. Their progress has been natural, highly efficient, and realized with almost frictionless ease. Because they were not held back by the sheer weight of resources others were employing, they were able to get some speed up. They had momentum. We went looking to find out exactly what this momentum was and how these momentum-powered firms acquired it.

The insight came when we realized that if momentum was powering a firm's success, then its *relative* marketing spend should be decreasing. Contrary to conventional "spend money to make money" wisdom, our hunch was that firms with momentum achieved superior growth while spending a relatively smaller percentage of their revenue on marketing than those pursuing the traditional "push hard" methods.

To test our hypothesis, we investigated the effect of marketing investments on the long-term growth of large, established firms. We looked at the conduct and performance of well-known corporations among the world's 1,000 largest, covering a 20-year period from 1985 to 2004. We looked at these firms' marketing behavior and tracked the effect that changes in this behavior had on sales revenue, net earnings, and stock price.[3]

The results were astounding.

Pushers, Plodders, and Pioneers

We divided the firms into three groups according to how their marketing behavior could be described: Pushers, Plodders, and Pioneers. Because we were interested in the effect of extremes in marketing behavior, our three groups were divided in a 25:50:25 split. For simplicity, let us illustrate the results of our research with an example from one sector, the largest: consumer goods and services.[4]

The Pushers were those companies that pushed their businesses hard in the traditional way, seeking to drive sales through aggressive increases in relative marketing spend. In our rankings, these were the firms in the quartile showing the highest increases in their marketing-to-sales ratio over the 20-year period. This group, on average, increased its marketing-to-sales ratio by 3 percent over this time.

Then there were the Plodders. These were the firms grouped around the middle of our sample—fully half of those in the study. Their marketing-to-sales ratio remained more or less constant for 20 years. These middling firms stayed in the safety zone of past behavior and took no drastic action one way or the other.

Finally, there was the remaining quarter—those firms that were, either boldly or foolhardily, heading in the opposite direction from the Pushers, and decreasing their relative marketing spend. Taking these firms' average marketing-to-sales ratio, we see a 4 percent drop over the timeframe.

This 4 percent cut was made while competing against the Pushers who were plowing in a 3 percent rise. In other words, the Pioneers cut their relative marketing spend by seven points when compared to the competition. Given the preeminence that marketing spend has among the tools most firms use to drive growth, this is a big, big call. Would these unconventional firms, which we dubbed the Pioneers, discover other avenues to growth, or fall behind as a result of their foolhardiness?

We expected these three strategic behaviors to have an impact on the firms' performance in creating shareholder value. What was not expected was the size of that impact.[5]

When looking at the percentage change in shareholder value over the 20-year period of our three groups, as compared to the change in the Dow Jones Index,[6] shown in Figure 1.1, we immediately see that remaining in the safety zone of stable marketing spend is not a viable option: The Plodders underperformed the stock market by 28 percent, achieving only 72 percent of the Dow Jones Index average growth.

As most analysts would have predicted, the highest increases in advertising ratio did produce significantly more shareholder value than did the Plodders' relatively stable marketing spend. Pushers managed, on average, to create shareholder value exactly in line with the evolution of the Dow Jones Index, thus demonstrating the soundness of the conventional faith in the power of active marketing spend to contribute to increasing shareholder value.[7]

What conventional analysis probably would *not* have predicted was the performance of the Pioneers. Despite having *decreased* their advertising-to-sales ratio, these momentum-powered companies created shareholder value 80 percent *above* the Dow Jones Index over the 20-year period. Eighty percent!

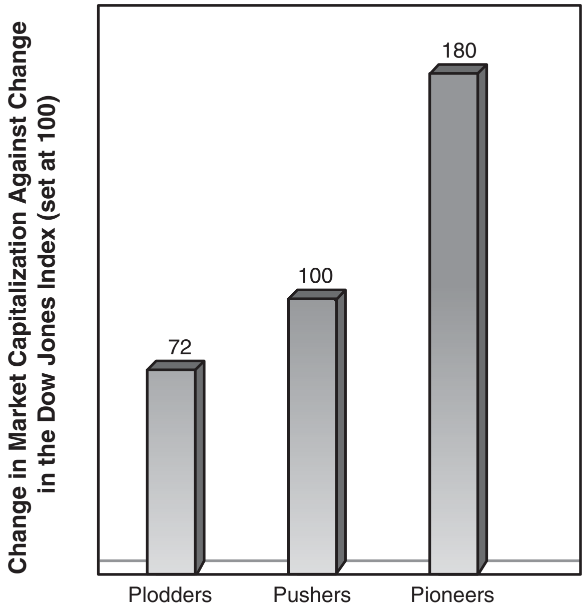

Figure 1.1 The three leagues, 1985–2004

As the limitations of the Plodders' inertia are obvious, let's leave them aside. Understanding the difference between the Pushers and the Pioneers—the "good" and the "great" in terms of growth in shareholder value—was both more challenging and more rewarding.

The first clue to the difference in the strategic behavior of these two groups appears in the top-line growth of the Pioneers, as shown in Figure 1.2. Over the 20-year period, using the Pushers' performance as a reference, the Pioneers' revenue growth was 93 percent better—almost twice as high. They achieved this massive revenue growth despite decreasing their advertising ratio. And remember: This is in comparison not to underperforming firms but to firms that actually matched the Dow Jones Index.

If we compare the *profitability* growth of these two groups, we can see that the Pioneers also did much better, with average earnings growth 58 percent superior to that of the Pushers.

A 58 percent advantage in earnings growth is very impressive, but it is noticeably smaller than the difference in revenue growth. Despite the Pushers' much poorer performance on revenue growth, *and* the fact that they were increasing their spending on marketing, they managed to claw back some lost ground: Their relative gap on earnings growth is less severe than one would expect. How did they manage that?

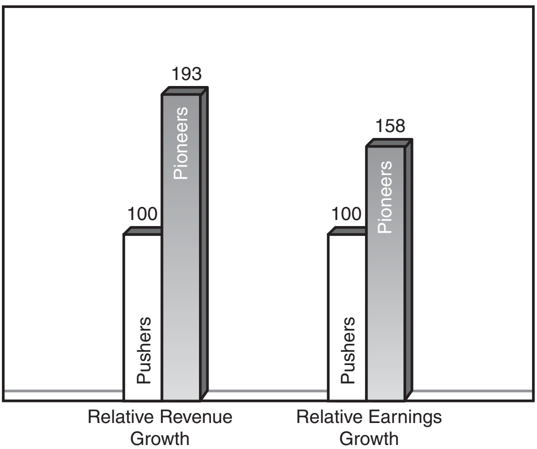

Figure 1.2 The two top leagues: Pushers vs. Pioneers, 1985–2004

They cut down on other costs, especially in manufacturing and R&D.[8] These combined cuts and efficiency economies more than compensated for the increase in advertising-to-sales ratio, and enabled the Pushers to peg back some of the Pioneers' huge top-line advantage when it came to earnings growth. Despite this partial catch-up, there is little doubt about where one would like to invest or work when one compares these two types of companies. The stock market recognizes this: The share-price premium of Pioneers over Pushers—80 percent—is significantly higher than the differential in their earnings growth.

The bottom line: Although the combination of pushing hard with marketing investments and slashing other costs can deliver growth, the Pioneers' achievements demonstrates that there is a more creative, exciting, and smarter alternative that delivers even better results.

Obviously, it is not as simple as cutting the advertising-to-sales ratio. A straight cut in advertising would almost certainly result in a drop in growth. In fact, our study shows that the momentum-powered Pioneers actually increased their total marketing expenditures in real terms. But while their marketing budgets were increasing, the proportion of their revenue that this expenditure represented was decreasing. In other words, because of the Pioneers' superior revenue growth, their advertising-to-sales ratio was coming down despite the fact that they were spending more.

In a world of increasing competition, marketing resources must also, inexorably, rise. But if they are to create sustainable, profitable growth, these expenditures must be invested in an effective manner. Compared to the Pushers, the Pioneers' increases in marketing investments were more effective: They got superior growth while reducing their marketing-to-sales ratio, thus improving profitability.

The question is: What was improving the efficiency of their marketing investments? This is not simply a case of great marketing, although marketing excellence is a key part of the mix. These firms achieved greater efficiency with their marketing because they found a different path to growth: They exploited the momentum effect. They created specific conditions that ignited an exceptional organic growth that feeds on itself: momentum growth.

We meet several firms that have managed to do this in the course of the following chapters. They come from domains as disparate as banking and ball bearings, but the central fact that unites them is this: It is their brains, not their muscle or money, that create the force to power them from success to success. They are momentum-powered firms.

Momentum-Powered Firms

The results of this research might seem counterintuitive at first sight, but they are perfectly logical. Too often, companies invest more in marketing to compensate for something: an inferior product, a poor pipeline of new products, deterioration of growth prospects, or a general lack of creativity.

Firms with such a limited vision compensate for their less-than-spectacular offers by pushing them on an unconvinced market using heavy-handed marketing resources. Even more compensation is required when, to fund this expensive marketing, they are forced to cut costs on the very activities that could improve the attractiveness of their offer: operations and R&D. This kind of behavior eats up resources and destroys firms from the inside out. These businesses will never build momentum. They are *momentum-deficient firms.*[9]

The Pioneers show there is an alternative. These momentum-powered firms don't have to push so hard because they have built up a momentum that improves their efficiency. Rather than just better-than-average growth, they deliver exceptional growth. Their growth is exceptional on two counts: It is both higher and more efficient.

Many of them manage to maintain their momentum for decades. Table 1.1 lists several, along with an estimate of the length of time during which they felt the momentum effect.[10]

Table 1.1 Momentum-powered firms

Firm	Years	Firm	Years
Apple	10	Nike	10
BMW	30	Rentokil	20
Dell	30	Sony	10
Enterprise Rent-A-Car	30	Starbucks	10
FedEx	30	SWA	10
First Direct	15	Swatch	10
IBM	50 plus 10	Tetra Pak	20
IKEA	20	Toyota	10
Johnson & Johnson	30	Virgin Atlantic	20
Microsoft	20	Wal-Mart	30

Of course, momentum can never be taken for granted. Even those firms that have managed to build their own wave and ride it to unimagined success can come crashing down through a moment's careless inattention. Fortunately, it can be regained, as the case of IBM shows—that is why we have noted that it enjoyed two separate periods of momentum: a prolonged spell in its early years under Tom Watson Sr. and Tom Watson Jr., and then the famous and oft-quoted recovery under Lou Gerstner.

We look at most of these firms throughout the book. Many of them are well known internationally. Others, such as Rentokil and First Direct, might not be. But all have enjoyed the power of the momentum effect. Indeed, we hope to convince you that momentum offers a more rounded explanation for their success—and, in some cases, subsequent fall from grace—than the usual explanations that you might have already encountered. If you think you've heard all there is to hear about oft-cited companies such as Microsoft, Apple, IBM Swatch, Wal-Mart, and Toyota, for example, read on—you might be surprised. And you might also discover some new momentum-powered firms from whom important lessons can be learned.

Over the next two chapters, we examine the source of momentum and how to exploit it through a momentum strategy and the momentum process, but for now, let's just see what it looks like in action.

The Power of Momentum in Action

Wal-Mart and Toyota are two apparently dissimilar firms. They operate in two different industries and come from different countries and cultures. But they are two of the world's 15 richest companies, and each is number one in its own industry. More importantly, both got there by creating the conditions needed for the momentum effect to emerge. Although one has lost its momentum, the other is still in full swing.

Wal-Mart

Sam Walton launched his company with a focus on customers. What is remarkable is the way that this customer focus created exceptional growth and continued to power Wal-Mart for many years after it had become a major industry force. Whatever its current challenges—and there are many—for the better part of a generation Wal-Mart was a momentum-powered firm.

Sam Walton knew about retail, but his main asset was the fact that he knew about customers. His strength was this: He liked to listen to them and observe them, and he understood their needs. When he started out, he related deeply to a very specific kind of customer—people like him, people from the United States' rural South.

Walton's customer orientation made him aware of the potential of this region's smaller towns. In 1962, when Wal-Mart was launched, the standard wisdom held that large retail operations could not survive in towns with fewer than 100,000 residents. But Walton decided that this was where opportunity lay, and he deliberately opened stores only in small towns where there was no large-scale competition.

Walton understood that these customers would value his offering, that they would appreciate being able to shop locally, rather than making long journeys to larger towns. He also realized that these shoppers were worth more than they seemed. Although their wallets weren't as full as those of people in large cities, Wal-Mart was able to command a higher share of their spending because there was no competition. The combination of cheaper premises, lower labor costs, no competition, and prices slightly higher than big-city competitors meant that Walton's customers were extremely profitable to service.[11]

This winning combination gave Wal-Mart the traction it needed to start building momentum. As the firm mushroomed, it continued to improve all aspects of its operation, from customer service to supply chain and supplier relationships. Eventually, Wal-Mart was able to glean economies of scale in purchasing to achieve its mantra of "Every Day Low Price" (EDLP) and gain further momentum.

EDLP runs counter to traditional retail promotions that lure customers into stores, hoping that they'll also end up buying more expensive products. The famous expression to describe retail strategy in the days before Wal-Mart was "an island of losses in an ocean of profits." It was really an island of bait in an ocean of arrogance and customer abuse. It was akin to duck hunting—attracting customers the same way hunters attracted wild ducks with decoys.

With EDLP, Wal-Mart turned the relationship with customers upside down. It moved from duck hunting to a vibrant partnership. Wal-Mart's competitors, to their discomfort, failed to understand that, although EDLP was jargon on the surface, it expressed a strong, hidden emotional value deeply appreciated by customers: trust. This customer trust powered the company's growth for decades.

Unfortunately, momentum doesn't look after itself. There is a perception that Wal-Mart slowly began to pay less attention to many of the key drivers of its success—respect for employees, local communities, and suppliers—and began to lose its momentum as a result. Momentum is dynamic: Unless it is constantly nurtured, it will ebb away. However, the reward for that unstinting attention can be immense—it can make you number one in the world.

Toyota

When asked in May 2007 about the prospect of Toyota becoming the world's number-one car manufacturer, company president Katsuaki Watanabe refused to take even a minute to gloat about beating his competitors. "Rather than think about other companies," he said, "I feel that we must do our utmost to satisfy customers around the world. There is plenty left for us to do."[12] This simple statement, reflecting an unswerving customer focus, demonstrates why companies like Toyota are able to develop a detailed and subtly nuanced understanding of customers—and why they are able to deliver better results.

It also shows that there is much more to Toyota's success than *Kaizen* and lean production. That is just the base: its excellence and efficiency at extracting value from its business. It is Toyota's ability to create new, original, and compelling value in the first place that drives its growth. Its secret is its ability to connect totally with customers' sense of self, to create products that are more than mere goods but complete, perfect, and compelling presentations of value. The Prius, for example, offers a package of utterly compelling value to environmentally aware city-dwellers: With its low carbon footprint, practicality for city driving, and celebrity association, it is more than just a car—it is a statement. The Lexus offers a totally different package of value to a totally different market, but the package is just as compelling, if you are part of its target market.

Consider the contrasting histories of the U.S. auto industry and Toyota. American car manufacturers are among the best illustrations of the limitations of the Pusher's strategy. They have given everything a try in terms of efficiency drives, but although they are now leaner, they are no fitter. They sought to drive top-line growth through expensive advertising as well as sales promotions to generate volume, along with deep discounts to move inventories of finished goods. These expensive tactics were needed to compensate for the failure of their products to really connect with customers.

Toyota, on the other hand, has become the world's largest and most profitable car manufacturer, riding a fantastic wave of momentum. Its success is based on a number of factors, but underlying its achievement is a deep understanding of its customers. First, Toyota proved that it could consistently deliver reliable, impeccably engineered automobiles. Once this crucial plateau had been achieved, it went on to innovate its range with cars that were somehow more than mere vehicles. Models like the Prius and the Lexus range appeared in their showrooms. Both of these cars connect on an emotional level with their drivers' self-image and aspirations—green and clean for the one, luxurious and status based for the other. This level of customer engagement did not happen by chance—it was the result of a focused, iterative process that created the conditions under which the momentum effect, and the efficient momentum growth it delivers, could flourish.

Join the Momentum League

We have spent many years focusing on the difference between the majority of ordinary firms and those few that deliver truly exceptional results.

Our research has shown that increases in marketing pressure can lead to significant profitable growth. The Pushers delivered good performance and matched the Dow Jones average over a 20-year period. But who wants average growth when there is a much better option?

The Pioneers—those momentum-powered firms that decreased their marketing-to-sales ratio—achieved revenue growth 93 percent greater than the Pushers. That is the sort of growth that gets companies noticed, that drives exceptional increases in value for all stakeholders.

How did they do it? By creating the conditions that are needed for the momentum effect to take place.

Ask yourself the question prompted by that meeting with a financial analyst at the beginning of this chapter: When are we going to start building some momentum? Momentum offers an easier, more efficient, and exceptional form of growth. But it requires the ambition to break free from the traditional reflex of using more resources to fuel it. The very things that seem to push you forward are holding you back. Momentum does not happen by chance. Nor can it simply be willed into existence. Achieving momentum requires an understanding of its source, and then the relentless application of a systematic process. It requires a momentum strategy.

Momentum leaders are not lucky—they are smart. They have discovered the source of momentum and, with it, the beginnings of a smarter way to exceptional growth. Managers often talk about "riding the wave." Momentum leaders aren't that passive. They live by this motto: First build your wave, *then* ride it.

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